15

No. 88-1400

In The

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF THE UNION OF INDUSTRIAL AND EMPLOYERS' CONFEDERATIONS OF EUROPE AND ORGANIZATION FOR FAIR TREATMENT OF INTERNATIONAL INVESTMENT INC. AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

ALEXANDER SPITZER
Nestlè Holdings, Inc.
Five High Ridge Road
Stamford, CT 06905
(203) 322-4567
Counsel of Record for Amici Curiae

12pp

QUESTION PRESENTED

Whether a foreign corporation that is denied standing in California courts to contest a California unitary tax assessment on its income from sources outside the United States has standing in federal court to seek protection from California tax and administrative burdens.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

No. 88-1400

In The

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF THE UNION OF INDUSTRIAL AND EMPLOYERS' CONFEDERATIONS OF EUROPE AND ORGANIZATION FOR FAIR TREATMENT OF INTERNATIONAL INVESTMENT INC.

INTEREST OF *AMICI CURIAE*

The Union of Industrial and Employers' Confederations of Europe (Union de Confederations de l'Industrie et des Employeurs d'Europe, known as UNICE) is recognized as official spokesman for European business and industry vis-a-vis European Economic Community and other European institutions. Its member federations are the official represen-

tatives of all sectors of business and industrial activity in their respective countries. UNICE comprises thirty-three member federations from twenty-two European countries, including all countries of the European Economic Community,[1] and of the European Free Trade Association.[2] UNICE's permanent secretariat is located in Brussels, Belgium.

One of the important areas covered by UNICE is the area of international double taxation. UNICE has a direct interest in having this Court decide the issue of standing in favor of the respondents, Alcan Aluminium Limited, a Canadian corporation, and Imperial Chemical Industries PLC, an English corporation. UNICE members are actual or potential investors in the United States. UNICE views California's worldwide unitary method tax as a direct impediment to international commerce and trade as well as to the flow of capital and intellectual property between the United States and nations which UNICE represents. UNICE is particularly concerned with the extraterritorial reach of California's unique method of taxation and the fact that California denies access to its courts to foreign investors within that reach.

The Organization For Fair Treatment Of International Investment Inc. (OFTII) is a Delaware nonprofit corporation with membership comprised of domestic subsidiaries of foreign corporations that do not themselves maintain permanent establishments in the United States.[3] OFTII was organized to represent its members' interests in matters of federal and state taxation and to seek both legislative and judicial

[1] The member nations of the EEC are: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxemborg, The Netherlands, Portugal, Spain, and the United Kingdom.

[2] The member nations of the EFTA are: Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

[3] OFTII members supporting this brief are: AKZO America, Inc.; Alcan Aluminum Corporation; Allied-Lyons North America Corp.; BASF America Corporation; BATUS Inc.; Beecham, Inc.; Foseco Minsep; Gold Fields American Corp.; Hoechst Celanese Corporation; ICI Americas Inc.; Moet & Hennessy; Nestlē Holdings Inc.; Shell Oil Company; Siemens Capital Corporation; Sony Corporation of America; Thorne EMI (USA), Inc.; Unilever United States; Volkswagen of America, Inc.; Volvo of America Corp.

solutions to problems affecting the economic interests of its members.

OFTII, similarly to UNICE, has a direct interest in the standing issue before this Court. OFTII members bear an increased tax burden under California law because they are treated as "unitary" businesses with their foreign parents and have their foreign parents' foreign incomes included in the domestic corporations' California income tax bases. In the event the foreign parents, who already are denied standing in California courts, are also denied standing in federal courts, the entire burden of contesting unitary tax assessments will fall on the domestic subsidiary corporations, the members of OFTII. Most of these members do not have foreign subsidiaries or foreign source income. They do not possess or have access to the information required to demonstrate the correct California worldwide unitary tax assessed on their parents' incomes. As domestic companies, OFTII members are not in a position to invoke the protection of the Federal Government's foreign commerce policies and international treaty commitments.

SUMMARY OF ARGUMENT

California's worldwide unitary tax method violates international practice and prevents the United States Federal Government from "speaking with one voice" in foreign commercial relations. Imposition of unitary taxes on the foreign revenue of foreign based multinationals interferes with the protection of investments and protection from double taxation and compliance burdens offered to foreign businesses by the international tax treaty network of which the United States is an integral part.

The respondents, foreign parents of subsidiaries operating in California, are themselves classified as "taxpayers" under California law. Yet California does not provide access to its courts to foreign parent companies who actually must bear the burdens of unitary double taxation and compliance. These respondents now seek to bring their cases before the

United States Federal Courts. Federal law grants this right in the absence of a "plain, speedy, and efficient" remedy in California. In recognition of the lack of a California state remedy, the Seventh Circuit Court of Appeals ordered these cases to go back to the District Court for decision on whether California's unitary method in fact violates the United States Constitution and foreign commercial policy established by the Federal Government. Because these foreign parents are the real parties in interest but are without recourse under California law, the Court of Appeals decision should be affirmed.

ARGUMENT

CALIFORNIA'S UNITARY TAX IS A DIRECT BURDEN ON FOREIGN COMMERCE AND FOREIGN BUSINESS ENTITIES. THIS SHOULD GIVE SUCH ENTITIES STANDING TO CHALLENGE IMPOSITION OF THESE BURDENS.

A. California's Violation of International Standards.

California assesses income taxes based on the worldwide income of multi-national business groups whether the parent companies are foreign or domestic. California is a large and important segment of the economy of the world as well as the foreign commerce of the United States. Because California is not an independent nation, there is no opportunity for foreign countries to negotiate with California for a mutually agreeable means of avoiding double taxation and imposition of unfair administrative and decisional burdens on their own nationals. This prerogative lies solely with the United States Federal Government.

The United States Federal Government has promoted and entered into a series of tax treaties and other international accords that employ the "arms's length" method of income taxation.[4] The international arm's length method recognizes

[4] These United States Tax treaties are in place with all of the EEC and EFTA countries as well as with many other nations, including Australia, Canada, Israel, Japan, and the Soviet Union.

separate identities of subsidiary companies. The arm's length method treats transactions among related companies across national borders as though the parties were unrelated. The fiscal authorities of each country are responsible for ensuring that correct accounting and pricing practices are observed within their respective national boundaries in order to prevent tax avoidance and shifting of income. Each country applies its own accounting principles to this end. The United States Internal Revenue Service, itself, has acquired an international reputation as a diligent and militant enforcer of the arm's length method. The arm's length method is accepted and employed by all of the members of the EEC and EFTA, as well as by Australia, Canada, Korea, Republic of China, and Japan. It is the undisputed international standard. Except for California, *amici* are unaware of any jurisdiction that does not apply the arm's length method to international transactions involving foreign nationals. *Amici* are aware there are three other states, Alaska, Montana, and North Dakota, that make use of the worldwide "unitary" method. Alaska, however, appears to apply the worldwide unitary method only to oil companies. Montana does not apply the worldwide unitary method to foreign based multinationals and the application by North Dakota is outside the experience of *amici*. *Amici* do not know whether the courts of Alaska and North Dakota are closed, as are California courts, to foreign parents of domestic subsidiaries in worldwide unitary tax cases.

One of the principal features of the internationally accepted method to provide for the avoidance of double taxation is to grant country of domicile tax credits to parent companies so as to prevent double taxation of income earned abroad by subsidiaries. See United Nations Model Double Taxation Convention Between Developed and Developing Countries, U.N. Doc. ST/WSA/102 (1977); U.S. Treasury Model Income Tax Treaty, June 16, 1981, 1 CCH Tax Treaties ¶153; Report of the OECD Committee on Fiscal Affairs, Model Double Taxation Convention on Income and Capital (1977). International usage recognizes that the country in which income is earned has the highest right to tax such income. The country to which income is repatriated

after having been earned abroad has the right to levy an incremental tax on that income only in the event its tax rate is higher than the source country's tax rate.

California's unitary tax method cannot be made to work together with the internationally accepted method to avoid double taxation and, more particularly, with the arm's length method in international commerce. California's method ignores separate corporate identities as well as national boundaries; gives no foreign tax credits; disregards taxation at source; and imposes compliance demands that are impossible to meet. See California Franchise Tax Board Regulations Section 25137-6. There is testimony on public record by California's own expert, Professor John K. Shank of Dartmouth College, that "I don't believe any foreign based multinational would have an accounting system that would enable it to produce a tax return in full technical compliance with California law." The reasons for this, as explained by Professor Shank, are, "one [problem] is the difference between accounting records for management purposes and public reporting purposes versus accounting standards for federal tax purposes. Those are different. And the second even beyond that are the different tax laws, plural, for individual states versus the federal tax laws. There are differences there." *Barclay's Bank International Ltd.* v. *Franchise Tax Board,* No. 325059 (1986), Superior Court of California, Sacramento County, transcript pp. 865-866, *appeal pending.*

By using the worldwide unitary method that conflicts with international and United States Federal standards, California imposes a substantial and discriminatory burden on multinational business transactions. This is particularly important to a foreign parent company which must either conform to California's tax program or keep its operations out of California. By having any significant operations there, the foreign parent subjects itself and all of its subsidiaries worldwide to double taxation, onerous compliance, and general interference with its fiscal affairs. These are not the results contemplated among nations when the United States Government promoted international free trade after World

War II. The countries of Europe and Asia entered into tax and trade accords with the Federal Government believing that it spoke for the United States. By applying its method of taxation to foreign based businesses, California flatly denies that the Federal Government speaks for California in matters of foreign trade and commerce.

B. The Foreign Parents' Standing to Challenge California's Practices.

California law regards a foreign business with a subsidiary establishment in California as a California taxpayer. California Revenue and Taxation Code Sections 25102, 25129, 25133, and 25134. Since, however, compliance and payment is only demanded from the subsidiary, it, alone, becomes the "corporation doing business within the limits of . . . California." California Revenue and Taxation Code Section 23151. By this simple semantical device, California denies the foreign taxpayer access to its courts and administrative process. This is taxation without recourse.

It is clear that California's principal purpose in taking this illogical stance is to prevent the constitutional and foreign commerce issues from being heard in any court, including its own state courts. Having lost in the California trial court in the *Barclay's Bank* case on the constitutional issue of applying unitary tax to foreign businesses, California is even more anxious to avoid any other court deciding that issue pending the appeal of the *Barclay's Bank* case.

California should not be allowed to make arbitrary and singular classifications detrimental to foreign commerce and persons. If the foreign parent is a taxpayer for assessment and compliance, it should also be a taxpayer for bringing suit to contest the taxes assessed. Since California has not provided access to its courts to such taxpayers, it follows that the Tax Injunction Act, 28 U.S.C. § 1341, has no application to this case. Neither should principles of comity and federalism prevent the Federal courts from taking jurisdiction to hear what is essentially a case concerning a challenge to Federal authority by California.

Both the petitioner, California's Franchise Tax Board, and the foreign parent respondents, Alcan Aluminium Ltd. and Imperial Chemical Industries PLC, agree that standing in this case depends upon a showing of direct injury to the party bringing suit. Both the petitioner and the respondents rely upon the same authorities for this proposition, *Simon* v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26 (1976) and *Valley Forge College* v. *Americans United*, 454 U.S. 464 (1982). If one accepts the basic premise of the unitary tax method, that a multinational business is interdependent and contributions of value flow equally to and from its affiliated organizations, then it follows that an injury to one part is an injury to the whole. California's contradictory posture in this case may be likened to a tort-feasor who injured a child denying that the child's parents have a cause of action of their own in respect of losing the child's services.

If, indeed, a business is "unitary" as California claims, there can be no distinction for standing purposes between taxing the subsidiary and taxing the parent. There should be no doubt as to the right of the *unitary business* to bring suit in California courts by its parent organization. By pretending that only the subsidiary corporation incurs the tax, California is denying the basic premise of its unitary method. This Court should not permit California to levy a tax on an entire business and then deny the right to the real party in interest, the parent organization which must protect the integrity of the entire business as well as the capital of the individual shareholders of the parent, to contest the tax. It is this unique feature of California's unitary tax method that distinguishes it from all of the cases involving suits by shareholders asserting the interest of their corporations. In the cases of the two foreign parents now before this Court, the real parties in interest are those foreign parents, not their United States subsidiaries who have only a secondary interest.

From a practical, business standpoint, the burdens that arise from an extraterritorial tax assessment create damage to the parent which is not, as such, damage to the subsidiary. This is so because the double taxation without access to the California court threatened by the California method of

taxation, will affect the relative attractiveness to the parent of operating in the United States through a subsidiary. To avoid such a threat, the parent would have to operate (a) through a branch, in which case the parent would have its own right to sue in a California court as in the *Barclay's Bank* case; or (b) through independent dealers and distributors, in which case there would be no California nexus for making tax assessments. These are the choices that the United States Court of Appeals (Seventh Circuit) understood were forced upon the foreign parent respondents in these cases in derogation of Federal foreign commercial policy. *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC* v. *Franchise Tax Board et al.*, 860 F.2d 688, 697 (7th Cir. 1988). If California is permitted to ignore Federal policy and force different choices upon foreign parent companies, foreign retaliation is clearly invited. The United Kingdom has already embarked upon such retaliation with the enactment of New Clause 27 to the United Kingdom Finance Act of 1985. This measure would penalize United States parent companies with California connections who do business in the United Kingdom.

The real danger in California's tax method is that it may cause international trade barriers that took more than forty years to dismantle to be reinstated. There is nothing except treaties and international usage to prevent other states in federal republics such as Brasil, Canada, or the Federal Republic of Germany, from enacting their own extraterritorial taxes, using totally different apportionment formulas than does California. A labor intensive state will use man hours; a high technology state will use only capital employed or value of intellectual property; a state rich in mineral resources will use extractive values as the measure of apportionment. California has chosen a formula that ensures income distortion in favor of its own economy, a combination of high cost real estate, high wages, and relatively low productivity. Even in interstate commerce within the United States, consumer states may use only a sales factor or else double weight sales in the three factor formula. *Cf. Shell Oil Co.* v. *Iowa Dept. of Rev.* ____ *U.S.* ____, 109 S. Ct. 278 (1988) (Where sales was the single factor).

Extraterritorial taxation is an insidious and dangerous impediment to international commerce. Should it proliferate, international trade will be severely damaged. One cannot establish production facilities in foreign countries if it means creating a pipeline into one's domestic accounts and revenues. Whether sanctions take the form of confiscating the income of the foreign operation or sequestering the foreign investment is immaterial. Capital will not be risked if there is little reward for its use and returns on capital are negated by double taxation and large tax compliance costs.

If California wishes to regard multinational businesses as monolithic, unitary, entities, subject worldwide to California law, then California should be made to bear the consequences of that choice. The parent in control itself should be permitted access to California courts. If California denies access to its own courts, then the United States Federal courts have an obligation to protect the treaty framework and foreign commerce policy established by the United States Government. If California does not wish to abide by the logic of its choice of the unitary method, it should then be prepared to accept the arm's length method insofar as foreign multinational corporations are concerned. California's withholding of even handed treatment in these cases is a patent effort to extract revenue from foreign based multinational groups by transforming foreign source income of the groups' foreign members into California revenues. The United States Government and this Supreme Court should not permit California to succeed in this effort. Should widespread foreign retaliation ensue, the result will be not merely double taxation, but such a multiplicity of taxation that foreign investment in the United States and United States investment in foreign nations will suffer. The negative effects on the economy of the United States and the world in the 1930s resulting from foreign retaliation to the Smoot-Hawley Tariff Act, 46 Stat. 590, should not be forgotten.

A final comment is offered on California's argument that the cost of complying with its worldwide unitary tax system falls only upon the subsidiary doing business in California and not the parent company. The detail and type of information

required by Franchise Tax Board Regulation Section 25137-6, make it clear that only the parent company could command this type of information. Since it is also clear that California really doesn't expect it to be produced, the argument made by California that the burden is only on the subsidiary takes on a new and sinister meaning: California's worldwide unitary tax on foreign multinationals isn't an income tax at all! It is a largely arbitrary mulct of foreign business. Since taxpayer records are privileged and income information is not shared among competitors, California feels secure that the discriminatory nature of this mulct will not come to light. This is, in short, taxation based on the time honored principle of "what the traffic will bear" applied arbitrarily and without general standards by which income of taxpayers can be fairly measured.

CONCLUSION

The foreign parent cases before this Court should not be dismissed on the issue of standing. These foreign parent company respondents should be given the opportunity, denied them in California courts, to prove the nature and extent of their economic injuries in the United States District Court. If the respondents claims are proven, the standing issue resolves itself and the reach of the Constitution's Commerce Clause on worldwide unitary taxation can be properly considered in context. Federal supremacy and international comity militate in favor of allowing the respondents to go forward with their cases. The decision of the Court of Appeals remanding these cases to the District Court should be sustained.

Respectfully submitted,

ALEXANDER SPITZER
Counsel of Record for

UNION OF INDUSTRIAL AND EMPLOYERS' CONFEDERATIONS OF EUROPE

ORGANIZATION FOR FAIR TREATMENT OF INTERNATIONAL INVESTMENT INC.

Amici Curiae